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TREASURY FOR OCC/EILEEN SIEGEL
TREASURY ALSO FOR OASIA/ICB/VIMAL ATUKORALA
TREASURY PLEASE PASS TO FEDERAL RESERVE AND SEC/E.JACOBS
JUSTICE FOR DOJ/CRM/ATMLS AND FOR OIA/RICHARD OWENS
FBI FOR CID

E.O. 12958: N/A
TAGS: EFIN PGOV ELAB AU
SUBJECT: Bank's Problems Shake Austrian Political Scene

Summary

¶1. Austria's fourth largest banking group, BAWAG P.S.K. (BAWAG), already reeling from questionable loans to the bankrupt U.S. futures and commodities brokerage firm Refco, has admitted it incurred (hitherto concealed) losses of Euro one billion in 2000. The losses stemmed from high risk speculative transactions via offshore centers in the Caribbean and Liechtenstein. BAWAG's 100% owner, the Austrian Trade Union Federation (OGB), covered the losses through a guarantee from the OGB's strike fund. The existence of the Caribbean losses emerged while auditors were researching BAWAG's involvement in the Refco bankruptcy, which cost the bank about Euro 400 million ($500 million) in 2005. Long-time OGB President Fritz Verzetnitsch has resigned from his position and also given up his parliamentary seat. The OGB announced March 30 it would sell BAWAG. With national elections in the fall, the conservative People's Party, the main partner in the governing coalition, will undoubtedly use the affair to portray the opposition Social Democrats as incompetent on economic issues. End Summary.

BAWAG's Refco Troubles

¶2. Immediately following the October 2005 bankruptcy of the U.S. commodities and futures brokerage firm Refco, Austria's fourth largest banking group, BAWAG P.S.K. (BAWAG), announced that it had an exposure to Refco of Euro 425 million ($530 million). Part of this exposure was a Euro 350 million ($438 million) loan that BAWAG provided to Refco on October 9, 2005, two days before the arrest of Refco CEO Phillip Bennett. BAWAG has subsequently sold parts of the loan, and reportedly written off the outstanding liability of Euro 392 million ($490 million) in its 2005 financial statement. The Refco case was serious for BAWAG, but given the bank's core capital and equity, it did not endanger the bank's financial stability. BAWAG CEO Erich Zwettler resigned in late 2005.

BAWAG's Caribbean Adventure

¶3. In the course of researching the Refco problems,

BAWAG's new CEO, Ewald Nowotny, uncovered a more damaging situation: losses of approximately Euro 1 billion incurred in 2000 from highly speculative transactions (interest swaps, currency derivatives, etc.). These transactions occurred through letter-box companies in offshore centers in the British Virgin Islands, the Channel Islands and Liechtenstein. Instrumental in these deals was Wolfgang Floettl, son of former BAWAG CEO Walter Floettl and manager of the Bermudan investment firm Ross Capital. In the early 1990s, BAWAG established a close relationship with Ross Capital. BAWAG had stopped these Caribbean deals in 1994 after negative publicity, which led to the resignation of CEO Walter Floettl. However, given that these businesses had been profitable, Floettl's successor, Helmut Elsner, resumed them in 1995.

¶4. BAWAG's losses in 2000, the year it acquired the postal savings bank P.S.K., reportedly would have led to the bank's insolvency. However, BAWAG's 100% owner, the Austrian Trade Union Federation (OGB), assumed liability for the losses to strengthen the bank's equity. OGB's guarantee, based on the assets of its strike fund, allowed BAWAG to restructure the loss and write it off over several years. BAWAG reportedly never used the OGB's guarantee, covering the losses with its own resources.

Clearing up the Mess

¶5. In a March 24 press conference, Nowotny confirmed that BAWAG operates offshore companies, but is

liquidating many of its firms in Anguilla. He maintained that BAWAG would also review its other offshore companies, most of which are not operative.

¶6. Following the resignation of BAWAG CEO Erich Zwettler in late 2005, other senior BAWAG officials stepped down, including Guenter Weninger, BAWAG Supervisory Board President and also the OGB Finance Manager. In a March 27 BAWAG supervisory board meeting, four of the bank's eight executive board members also resigned under pressure. The surviving four members were either new appointees or had joined the board following the P.S.K. merger. BAWAG reportedly is preparing to file civil damage claims against Floettl and two of the bank's former CEOs, Helmut Elsner and Erich Zwettler. The Financial Market Authority has initiated a special audit of BAWAG. The public prosecutor is also investigating the case.

Domestic Political Fallout

¶7. On March 27, long-time OGB President Fritz Verzetnitsch resigned and also gave up his parliamentary seat in reaction to BAWAG's fiasco. Verzetnitsch, who had been OGB President since 1987, was the sole signatory to the one billion Euro guarantee in 2000. Verzetnisch denied any misconduct, arguing that his only goal had been to save BAWAG from collapse. However, there will likely be additional questions about OGB business activities and its internal organization. A likely drop in BAWAG's 2005 dividend may have serious impact on the OGB's financial situation. On March 30, the OGB announced it would sell BAWAG. Questions have also arisen concerning the role of BAWAG's outside auditor, KPMG, as well as the responsible government commissioners on the BAWAG board and the bank supervisory authority, which, in 2000, was a Finance Ministry department.

Comment

¶8. With national elections in the fall of 2006, the BAWAG-OGB debacle has become a major political headache for the opposition Social Democratic Party (SPO). SPO Party Chairman Alfred Gusenbauer has stated that the BAWAG ordeal is not an SPO problem. Nevertheless, the SPO's dominance in the OGB is obvious. The conservative People's Party will surely highlight the issue as evidence of the SPO's economic incompetence.

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